(3)

No. 93-952

Supreme Court, U.S.
FILED
FEB 16 1994
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,
Petitioners,2

v.

ABBE KANAREK PATTERSON, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal, First Appellate District

---

REPLY MEMORANDUM

JOHN W. COTTON
VINCENT J. DAVITT
AARON C. GUNDZIK
KATHERINE E. MONAHAN
LEBOEUF, LAMB, GREENE & MACRAE
725 South Figueroa Street
Thirty-Sixth Floor
Los Angeles, CA 90017
(213) 955-7300

ROBERT H. CARPENTER
THEODORE FISCHKIN
J. KIEFFER
RANDY DECKER
ITT Consumer Financial Corporation
605 Highway 169 North
Suite 1200
Minneapolis, MN 55441
(612) 595-1000

*THEODORE B. OLSON
THEODORE J. BOUTROUS, JR.
MARK SNYDERMAN
GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5306
(202) 955-8500

Attorneys for Petitioners

**Counsel of Record*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. 1-800-347-8208

13PP

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
REPLY MEMORANDUM	1
CONCLUSION	10

TABLE OF AUTHORITIES

Cases:	**Page**
Bayma v. *Smith Barney, Harris Upham and Co.*, Inc., 784 F.2d 1023 (9th Cir. 1986)	4
Coenen v. *R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972)	7
Cohen v. *Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988)	2,3,4
Cost Brothers, Inc. v. *Travelers Indem. Co.*, 760 F.2d 58 (3d Cir. 1985)	5
Eassa Properties v. *Shearson Lehman Bros., Inc.*, 851 F.2d 1301 (11th Cir. 1988)	5
Genesco, Inc. v. *T. Kakiuchi & Co., Ltd.*, 815 F.2d 840 (2d Cir. 1987)	5
Mago v. *Shearson Lehman Hutton Inc.*, 956 F.2d 932 (9th Cir. 1992)	1,2
Meyers v. *Univest Home Loan, Inc.*, No. C-93-1783 MHP, 1993 WL 307747 *2-3 (N.D. Cal. Aug. 4, 1993)	6
Mitsubishi Motors Corp. v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985)	6,7
Moses H. Cone Memorial Hosp. v. *Mercury Constr. Co.*, 460 U.S. 1 (1983)	7,9
Perry v. *Thomas*, 482 U.S. 483 (1987)	3,6
Southland Corp. v. *Keating*, 465 U.S. 1 (1984)	6
Teledyne, Inc. v. *Kone Corp.*, 892 F.2d 1404 (9th Cir. 1990)	4

Statute:

Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.* ... *passim*

REPLY MEMORANDUM

Petitioners (collectively "ITT") file this memorandum in reply to respondents' brief in opposition:

1. The California Court of Appeal in this case applied state-law unconscionability principles to deny enforcement of arbitration agreements governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, *et seq.* ITT explained in its certiorari petition that this decision directly conflicts with the rule in the Ninth Circuit that the enforcement of arbitration agreements is governed exclusively by federal law, and implicates a larger disagreement among federal and state courts as to when, if ever, state law may be used to deny arbitration enforcement. In opposition, respondents rely on mischaracterization of case law and a meaningless rule of decision of their own creation to argue that the courts are in harmony. One need only read the relevant decisions to refute respondents' claim absolutely; there is a real and important split of authority that this Court should resolve.

a. There is an express and direct conflict between the California Court of Appeal decision in this case and decisions of the Ninth Circuit. Petition at 8-14. The Ninth Circuit rejects explicitly any application of state-law adhesion and unconscionability principles to bar arbitration under the FAA. *E.g., Mago v. Shearson Lehman Hutton Inc.*, 956 F.2d 932, 934 (9th Cir. 1992) ("state law adhesion principles may not be invoked to bar arbitrability of disputes under the [FAA]") (internal quotations omitted). The California Court of Appeal applied state-law principles of adhesion and unconscionability in this case.

Unable to avoid this obvious conflict, respondents resort to gross mischaracterization of the relevant Ninth Circuit authority. Nowhere is this more evident than in respondents' misquotation of the Ninth Circuit's recent decision in *Mago, supra*. Respondents contrast the statement from *Mago* quoted above—concerning the inapplicability of state law—with the following statement from the same opinion: "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract." 956 F.2d at 934 (internal quotations omitted), quoted in Opp. at 17. The clear implication of respondents' quotation is that the *Mago* court, like the California Court of Appeal here, was looking to state law on these questions. But respondents have deliberately failed to include the Ninth Circuit's introduction to the quoted passage, in which the court reiterated that federal, not state, law is applicable: "[A]n arbitration agreement may be unenforceable under principles of *federal law*:" 956 F.2d at 934 (emphasis added). The contrast with the California Court of Appeal decision in this case could not be more stark.

Respondents attempt much the same sleight of hand with *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988). The Ninth Circuit there rejected the Cohens' claim that the arbitration clause in a loan agreement was "unenforceable as an unconscionable provision of a contract of adhesion." *Id.* at 285. Respondents argue that "[t]he Ninth Circuit did not dismiss this contention as inappropriate under federal law," but rather decided the issue solely on the basis that the SEC had authorized the arbitration proce-

dures at issue. Opp. at 17. Respondents' description of *Cohen* is incomplete and therefore demonstrably incorrect. Following the discussion of SEC authorization, the Ninth Circuit announced a separate ruling on the Cohens' adhesion claim, a ruling that conflicts directly with the California Court of Appeal decision in this case: "Our conclusion [regarding SEC authorization] is not affected by the Cohens' contention that the arbitration agreement is a part of a contract of adhesion. We have previously held that state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the Arbitration Act." 841 F.2d at 286.

b. Respondents fare no better when they attempt to explain away the clear divergence among state and federal courts, and indeed within the decisions of this Court, on the broader issue of when, and under what circumstances, state law may be invoked to deny arbitration enforcement. Respondents create, and then exclusively rely upon, a specious distinction between the "validity and enforceability" of arbitration agreements on one hand, and the "scope of arbitrable issues" on the other. Opp. at 2, 13. According to respondents, *Perry v. Thomas*, 482 U.S. 483 (1987), and other decisions of this Court establish that the "validity and enforceability" of arbitration agreements is to be determined by state law, while the "scope of arbitrable issues" is a matter of federal law, Opp. at 12-13, and respondents claim there is no confusion about this rule among other federal and state courts. *Id.* at 14-21.

Respondents' distinction is false both as a matter of law and as a description of what the courts have held. The distinction is meaningless as a matter of

contract law because the scope of issues covered by an arbitration clause *is* a question of contract enforceability; if courts apply federal law to the question of the scope of arbitrable issues (or "arbitrability" as respondents sometimes refer to it), they are by definition applying federal law to determine whether, and to what extent, an agreement should be enforced. For example, respondents claim that the issue in *Cohen, supra*, was "primarily one of arbitrability of issues," and not validity or enforceability. Opp. at 16. The Ninth Circuit did indeed discuss "questions of arbitrability" in that case. 841 F.2d at 285 (internal quotations omitted), quoted in Opp. at 16. But the court was referring to the question whether the arbitration clause at issue was "unenforceable as an unconscionable provision of a contract of adhesion." 841 F.2d at 285.[1] Thus, there is no distinction between "arbitrability" and enforcement of an arbitration agreement.[2]

More important than their failure of nomenclature, respondents are flat wrong when they claim that the

---

[1] The same is true of *Bayma v. Smith Barney, Harris Upham and Co., Inc.*, 784 F.2d 1023 (9th Cir. 1986). While the Ninth Circuit there "defined the issue as primarily one of arbitrability," as respondents assert, Opp. at 15, the issue was whether an "arbitration clause was a contract of adhesion." 784 F.2d at 1023.

[2] Respondents cite *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404 (9th Cir. 1990), as consistent with their "validity and enforceability" rule. Opp. at 18. However, *Teledyne* involved the question whether a contract *existed*—not whether an existing contract was valid and enforceable. 892 F.2d at 1410-11. The existence of the arbitration agreements in the case at bar was not at issue; the only issue was whether the agreements were unenforceable because allegedly unconscionable. *See* Petition at 12 n.5.

courts are in agreement that the validity and enforceability issue is a matter of state law. Respondents may find their "validity and enforceability" rule clearly established, but the courts have not. ITT cited in its petition more than a dozen cases in which federal and state courts have applied *federal* law to the enforcement of arbitration agreements. Petition at 13 & 14 n.7.[3]

Moreover, ITT cited more than a half dozen federal and state cases applying federal law to the question of unconscionability, precisely the issue of "validity and enforceability" that respondents claim is clearly controlled by state law. Petition at 13. Whatever the merits of respondents' asserted "arbitrability-enforceability" distinction, and no matter how one categorizes questions of unconscionability, respondents cannot deny that numerous courts have applied federal law to the issue of unconscionability of arbitration

---

[3] *See, e.g., Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 845 (2d Cir. 1987) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing questions of the validity and the *enforceability* of arbitration agreements under its coverage") (emphasis added); *Cost Brothers, Inc. v. Travelers Indem. Co.*, 760 F.2d 58, 60 (3d Cir. 1985) ("questions of the construction of arbitration agreements and their *enforceability* are governed by federal substantive law") (emphasis added).

Remarkably, respondents cite and quote *Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988), for the proposition that "federal law . . . govern[s] the interpretation and *enforcement* of a valid arbitration agreement" (emphasis added), just pages after they claim that it is well established that the "enforceability" of arbitration agreements is a matter of state law. *Compare* Opp. at 13 *with* Opp. at 19.

agreements, in direct contravention of the California Court of Appeal decision here.

This Court also has indicated that enforcement of arbitration agreements is a matter of federal law. *E.g., Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) ("[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state . . . attempts to undercut the enforceability of arbitration agreements"); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985) ("The preeminent concern of Congress in passing the [FAA] was to enforce private agreements into which parties had entered, a concern which requires that [courts] rigorously enforce agreements to arbitrate.") (internal quotations omitted). At the same time, dictum in *Perry v. Thomas* indicates that arbitration-neutral *state* law may be applied to the "enforceability" of arbitration agreements. 482 U.S. at 492 n.9.

This apparent inconsistency between *Perry* and other pronouncements from this Court has led to confusion in federal and state courts.[4] While most courts apply federal law exclusively to arbitration enforcement questions,[5] the First and Fourth Circuits look

---

[4] *See, e.g., Meyers v. Univest Home Loan, Inc.*, No. C-93-1783 MHP, 1993 WL 307747 *2-3 (N.D. Cal. Aug. 4, 1993) (applying federal law to the question of unconscionability of arbitration agreements, but noting tension between Ninth Circuit rule and *Perry*).

[5] Respondents argue that some of these cases can be distinguished because they were decided before *Perry*. Opp. at 15, 20. (This distinction is self-contradictory; respondents earlier in their brief contend that the "validity and enforceability" rule had been well established by Supreme Court cases prior to *Perry*.

to arbitration-neutral state law. Petition at 17-18. Respondents' meaningless "enforceability" versus "arbitrability" distinction does nothing to harmonize these cases. There is real confusion in the lower federal and state courts, and some inconsistency in the decisions of this Court, that the Court should clarify.

2. That this case implicates a clear split of authority between the California courts and the Ninth Circuit and a more general confusion among federal and state courts is reason enough for this Court to take the case. But the decision below is particularly dangerous because it is contrary to the strong federal policy favoring arbitration. Petition at 8-13, 18-20. The California Court of Appeal decision represents a return to the "anachronistic judicial hostility to agreements to arbitrate," that the FAA was designed to overcome. *See Mitsubishi Motors*, 473 U.S. at 625 n.14.

a. Respondents contend that the Court of Appeal decision is nothing more than run-of-the-mill appli-

---

Opp. at 13.) Most cases ITT cites are more recent than *Perry*; and respondents fail to address the bulk of them.

One case respondents dismiss as a relic of the benighted pre-*Perry* days is *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972). Opp. at 20. The *Coenen* court explained that "[o]nce a dispute is covered by the [FAA], federal law applies to all questions of interpretation, construction, validity, revocability, and enforceability." *Id.* at 1211. ITT cited *Coenen* not merely as Circuit authority, but as *Supreme Court* authority; this Court cited *Coenen* as a proper exposition of federal law in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 25 n.31 (1983). If respondents believe that the *Perry* dictum may be read to overrule *Moses H. Cone sub silentio*, that is all the more reason for the Court to take this case.

cation of settled unconscionability principles to a unique set of facts. Opp. at 21-29. In fact, the decision below was an unadulterated attack on arbitration rules and procedures, based on unsubstantiated fears that those procedures did not afford adequate protection to hypothetical parties.

Respondents presented a purely facial challenge to NAF rules and procedures; respondents claimed unconscionability not because they had been misled or suffered any unfairness as a result of the procedures, but because the arbitration procedures *in the abstract* might mislead. Respondents presented no evidence that these procedures had ever worked any unfairness against anyone.[6] The Court of Appeal ruling on this abstract challenge is, by definition, not "limited to

---

[6] Among the allegedly misleading procedures about which respondents made no showing was the site of arbitration. Respondents now assert that California residents were "required . . . to submit to arbitration in a forum located in Minneapolis, Minnesota." Opp. at 2. This is simply not true. The Court of Appeal acknowledged that the relevant NAF rule, as referenced in the arbitration agreements, permits a hearing in the judicial district where the arbitration agreement was signed. Pet. App. 7a. Respondents argued, and the court below agreed, that this provision *might* confuse borrowers, but no one ever contested that respondents could have arbitrated their disputes in San Francisco had they so chosen. The fact is, respondents never read their arbitration agreements or attempted to arbitrate their disputes in San Francisco or anywhere else and therefore could make no showing that they had been misled by the NAF rule in question. Nor did respondents show that anyone else had ever been misled by that rule. Respondents' attack, and the court's ruling, were based solely on speculation that the rule might be unfair if it were misconstrued by hypothetical borrowers. Any court applying a presumption in favor of arbitration, as the FAA demands, could not have reached this conclusion.

the unique facts of this case." *See* Opp. at 4. It is judicial hostility toward arbitration *simpliciter*.

b. Respondents also argue that the California Court of Appeal decision is consistent with unconscionability decisions under federal law. Opp. at 21-24. But under federal law there is a presumption in favor of arbitration. *Moses H. Cone*, 460 U.S. at 24-25. It is for this reason that ITT was able to cite numerous cases applying federal law to uphold arbitration agreements against unconscionability attacks, Petition at 13, and respondents were unable to cite even one case applying federal law to find an arbitration agreement unconscionable. In the absence of any showing of actual harm or unfairness, as was the case here, and with a presumption in favor of arbitration, any court applying federal law will enforce arbitration agreements. The California Court of Appeal displayed judicial hostility toward arbitration and applied unconscionability principles that are directly *contrary* to federal law.

CONCLUSION

For the foregoing reasons and those set forth in ITT's petition, the Court should grant a writ of certiorari and set the case for plenary review.

February 16, 1994

Respectfully submitted,

JOHN W. COTTON
VINCENT J. DAVITT
AARON C. GUNDZIK
KATHERINE E. MONAHAN
LEBOEUF, LAMB, GREENE & MACRAE
725 South Figueroa Street
Thirty-Sixth Floor
Los Angeles, CA 90017
(213) 955-7300

ROBERT H. CARPENTER
THEODORE FISCHKIN
J. KIEFFER
RANDY DECKER
ITT Consumer Financial Corporation
605 Highway 169 North
Suite 1200
Minneapolis, MN 55441
(612) 595-1000

*THEODORE B. OLSON
THEODORE J. BOUTROUS, JR.
MARK SNYDERMAN
GIBSON, DUNN & CRUTCHER
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5306
(202) 955-8500

Attorneys for Petitioners

**Counsel of Record*